No. 82-914

IN THE

Supreme Court of the United States

October Term, 1982

MONSANTO COMPANY,

Petitioner,

vs.

SPRAY-RITE SERVICE CORPORATION,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

BRIEF OF ASSOCIATES FOR ANTITRUST ANALYSIS AS AMICUS CURIAE IN SUPPORT OF PETITIONER AND MOTION FOR LEAVE TO FILE OUT-OF-TIME BRIEF AS AMICUS CURIAE IN SUPPORT OF PETITIONER.

WESLEY J. LIEBELER,
(Counsel of Record),
UCLA LAW SCHOOL,
405 Hilgard Avenue,
Los Angeles, Calif. 90024,
(213) 825-1994,
Attorney for Amicus Curiae.

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MOTION FOR LEAVE TO FILE OUT-OF-TIME BRIEF AS AMICUS CURIAE IN SUPPORT OF PETITIONER.

Amicus Curiae respectfully moves for leave to file out-of-time the attached Brief *Amicus Curiae* in Support of Petitioner. The time for filing such briefs expired May 14, 1983. The consent of both parties, however, has been obtained for the filing of this brief and both parties have consented to its being filed out-of-time. Letters to this effect from counsel for both parties have been filed with the Clerk of this Court. It appears that respondent will not be prejudiced by the filing of the brief out-of-time since it has sought and obtained an extension of time to file its own briefs in this matter. Respondent will, therefore, be able to answer or comment on this brief in its own filings should it so desire.

It also appears that the attached brief makes an argument for reversal that was not made either by petitioner or by other parties filing briefs *amicus curiae* on its behalf.

Respectfully submitted,

WESLEY J. LIEBELER,
(Counsel of Record),
UCLA LAW SCHOOL,
Attorney for Amicus Curiae.

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MONSANTO COMPANY,

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Respondent.

BRIEF OF ASSOCIATES FOR ANTITRUST ANALYSIS AS AMICUS CURIAE IN SUPPORT OF PETITIONER.[1]

Interest of Amicus Curiae.

Associates for Antitrust Analysis (AAA) is a group of faculty members from UCLA interested in the application of economic principles to government regulation in general and to antitrust law in particular. A list of members is attached as Appendix A. Financial support for this brief has been provided by the Center for the Study of Political Economy, Graduate School of Management, UCLA.[2] No support has been provided by either of the parties to this litigation.

The central issue in this case is whether government regulation of market processes will be expanded or contracted. The more particular question is whether the start which the

[1]This brief is filed with the consent of the parties pursuant to Supreme Court Rule 36.2. The written consents have been filed with the Clerk of the Court.

[2]The views expressed here are those of AAA and its members; they do not necessarily represent the view of the Regents of the University of California or UCLA.

Court made in *GTE Sylvania*[3] and in *Broadcast Music*[4] to base antitrust law on "demonstrable economic effect"[5] will proceed or be abandoned. AAA has an interest and an expertise in these issues. This brief addresses the economic issues in this case and the relationship between them and the relevant legal rules.

Summary of Argument.

This case raises again one of the most troublesome issues in antitrust: What principles determine the scope of the *per se* rule and the rule of reason. A second question, what kind of inquiry is to be conducted under the rule of reason when it applies, does not arise in this case because plaintiff proceeded below only on a *per se* theory.

This Court has made it increasingly clear that the purpose of antitrust law is to help maximize consumer welfare, *i.e.*, to help increase the productivity of our predominantly free market economy. To serve this purpose, the *per se* rule can properly be applied only to restrictive transactions which do not have any significant capacity to create efficiency.

This standard for the scope of the *per se* rule is based on demonstrable economic effect, as required by *Sylvania*. It is different from the standard that was applied in the vast majority of cases decided before *Sylvania*. The traditional standard is based primarily on form. That standard provides that certain forms of arrangements — price fixing, group boycotts and tie-ins — are illegal *per se*. The fact that some arrangements taking these forms can often produce significant efficiencies is irrelevant under the general statement of the rule. Legality depends on form rather than on effect.

A standard based on form, however, tends to come apart when it becomes clear that an arrangement which it makes

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[3]*Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

[4]*Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979).

[5]*Sylvania*, 433 U.S. at 59.

illegal *per se* in fact creates significant efficiencies. Most courts are reluctant to strike down transactions that are obviously wealth producing. When confronted with an efficiency creating arrangement which the law holds to be illegal *per se*, many courts will try to find some way to avoid the rule.

This was true even before *Sylvania*, as the law of group boycotts, for example, makes clear.[6] This Court made broad statements that group boycotts were illegal *per se*; when lower courts confronted efficiency creating boycotts they often refused to apply the *per se* rule.[7] This has led to considerable confusion in that area of the law.

Sylvania complicated the problem even more when, announcing that departures from the rule of reason were to be based on demonstrable economic effect, it applied the rule of reason to certain distribution arrangements because they created efficiency. Many of the Court's prior decisions had applied the *per se* rule on the basis of a predominantly formal standard to arrangements that were designed precisely to create efficiencies of the type approved in *Sylvania*.[8] While *Sylvania* thus undercut many earlier decisions, none of this was mentioned in *Sylvania* itself.[9]

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[6] *See* W. Liebeler, *Antitrust Advisor* §1.32 (2d ed. Supp. 1982).

[7] The court in *Cullum Electric & Mechanical, Inc. v. Mechanical Contractors Assn.*, 436 F.Supp. 418 (D. S.C. 1976), *aff'd* 569 F.2d 821 (4th Cir. 1978), stated that "[d]espite the pronouncements of the Supreme Court, a multitude of lower courts have continued to evaluate alleged boycotts under a 'rule of reason' analysis rather than by the per se doctrine employed by the Supreme Court. . . . As one commentator has observed, 'the law in Washington, however, is quite different from the law in the rest of the country.' " 436 F.Supp. at 428.

[8] The three principal cases are *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *United States v. General Motors Corp.*, 384 U.S. 127 (1966); and *United States v. Sealy, Inc.*, 388 U.S. 350 (1967). The arrangements in all three cases appear to have been aimed at free rider problems similar if not identical to those involved in *Sylvania*. *See* R. Bork, *The Antitrust Paradox* 332 (1978); Liebeler, *Book Review*, 66 Cal. L. Rev. 1317 (1979), at 1325; Liebeler, *Intrabrand "Cartels" Under* GTE Sylvania, 30 UCLA L. Rev. 1 (1982), at 31 (hereinafter cited as Liebeler, *Intrabrand "Cartels"*).

[9] *See* Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. Chi. L. Rev. 1 (1977).

Lower courts were thus faced with two conflicting lines of authority. One was based on earlier cases like *Klor's*[10] and *Sealy*,[11] for example, which formalistically applied the *per se* rule to efficiency creating arrangements. The other was based on *Sylvania*, which applied an economic analysis to uphold restrictions because they created efficiency. Lower courts could decide cases like the one under review pretty much as they desired, just by choosing to follow the earlier cases, which *Sylvania* had not *explicitly* rejected, or to follow *Sylvania*. The former is exactly what the court below did.

There is a conflict between *Sylvania* and earlier cases like *Klor's, General Motors*[12] and *Sealy* which the Court must resolve before we can expect any consistency in the decisions below.

The foregoing explains why the law governing the scope of the *per se* rule and the rule of reason is as confused as it is. This confusion imposes significant costs on the economy. There is more litigation than need be and businessmen find it hard to plan their affairs to stay within the law. The condition of the law in this area as it now stands is highly unsatisfactory.

For these reasons the Court should take this opportunity to clarify the scope of the *per se* rule and the rule of reason. A general statement of the efficiency approach adopted in *Sylvania* and advanced in this brief would help the lower courts decide all kinds of cases brought under Section 1 of the Sherman Act. It would also help businessmen plan their affairs, and lawyers to advise them. Such a statement would continue the process begun in *Sylvania*; it could contribute significantly to the efficiency of both the legal and the market systems.

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[10] *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959).
[11] *United States v. Sealy, Inc.*, 388 U.S. 350 (1967).
[12] *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

When it comes specifically to restricted distribution systems, lower courts have confronted two principal problems in their attempts to apply the economic approach adopted in *Sylvania*. The first, and the main point on which the court below erred, is the distinction between "price" and "nonprice" restrictions. This characterization issue is crucial because of *Sylvania's* holding that the *per se* rule continued to apply to "price" arrangements, while "nonprice" restrictions were to be governed by the rule of reason. While the distinction seems simple, the discussion below will show that it is quite intractable. There are only two principled ways to deal with the distinction. It could be formally abandoned, as suggested by the Solicitor General.[13] Under this approach, the rule of reason would be explicitly applied to all distribution restrictions. Another approach, urged in this brief, would apply the characterization process described in *Broadcast Music* to determine which distribution restrictions constitute "*per se* price fixing." The *per se* rule would be applied to those restrictions; the rule of reason would be applied to all others.

The second principal problem is the distinction between vertical and horizontal arrangements. This characterization issue, too, is important because it determines the scope of the *per se* rule. *Sylvania* placed horizontal transactions under the *per se* rule and vertical "nonprice" agreements under the rule of reason. Attempts to make this vertical/horizontal distinction have led lower courts into a veritable jungle of formalistic line drawing.[14] The *Sylvania* standard itself is faulty here. A distinction based on the source of the arrangement is formalistic itself; the source of an arrangement, even if it could be determined without endless circumlo-

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[13] *See* Brief for the United States as *Amicus Curiae* in Support of Petitioner, *Monsanto Company v. Spray-Rite Service Corporation*, at 19.

[14] The clearest recognition of this is Judge Posner's opinion in *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742 (7th Cir. 1982).

cution, has no necessary relationship to its price and output effects. If the vertical/horizontal distinction is to persist in this area of the law, it must be based on something that bears some plausible relationship to economic effect.[15] A standard based on the source of an arrangement does not meet that test.

The court below applied the *per se* rule primarily because plaintiff alleged that its termination was part of a plan to fix resale prices.[16] If this is all it takes to turn a nonprice restriction into a price restriction, there is little left of *Sylvania*. For this reason the approach taken below cannot stand. Neither the cases nor the commentators, however, have yet articulated a principled way to distinguish between "price" and "nonprice" restrictions. The other briefs in this case have not dealt effectively with this problem either.[17] This brief will, accordingly, focus primarily on that problem.

Section I of the brief discusses the economic factors relevant to any inquiry under Section 1 of the Sherman Act. It briefly describes the nature of "consumer welfare," the maximization of which underlies modern antitrust policy.

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[15]It would be best to tie the definition of the two terms directly to the possible economic effects of an arrangement. Thus, Bork says: "The test is simply whether, assuming market power to exist, the agreement eliminating competition could lead to a restriction of output. If it could, the restriction is horizontal; if it could not, the restraint is vertical." Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 Yale L. J. 373 (1966), at 424 (hereinafter cited as Bork, *Rule of Reason*). One way to implement this insight is to equate vertical with intrabrand and horizontal with interbrand. *See* generally Liebeler, *Intrabrand "Cartels."*

[16]In its discussion of the boycott issue, however, particularly in footnote 4, the court below suggests that the *per se* rule would apply even in the absence of resale price fixing. *See* Section III below.

[17]The Brief for the United States as *Amicus Curiae* in this case suggests that the restrictions here should be regarded as "nonprice" because "Monsanto's marketing program on its face did not pertain to price." *Id.* at 15. This is basically a formalistic approach. Monsanto argues that the rule of reason should apply unless "non-price restrictions are designed or used to implement a scheme to control resale prices and prevent intrabrand price competition." Petitioner's Brief at 26. It is not clear how we distinguish such arrangments from those that "affect price or limit intrabrand price competition." *Id.* at 27.

It shows that under the consumer welfare standard the *per se* rule is properly applied only to transactions with a significant potential to restrict output and which lack a significant efficiency creating potential. The rule of reason comes into play if both output restricting and efficiency creating effects are present. The rule of reason inquiry itself involves a balancing of these two effects. This section also describes certain proxies that help the courts identify those transactions that have either an efficiency creating or an output restricting potential.

Section II of the brief shows that the "price"/"nonprice" distinction which *Sylvania* used to determine the scope of the *per se* rule is intractable as now articulated. The reason is that "nonprice" arrangements (governed by the rule of reason under *Sylvania*) adopted to alleviate free rider problems must affect price to accomplish that purpose; the *Socony-Vacuum* rule, however, makes all arrangements which have even an indirect affect on price illegal *per se*. This dilemma can be avoided by using the characterization process which the Court adopted in *Broadcast Music*. This section also deals with the current vitality of *Broadcast Music* despite its seeming limitation in *Maricopa*.[18] It is concluded that *Broadcast Music* provides the only principled way to determine the scope of the *per se* rule in this area of the law, short of overruling *Dr. Miles* and applying the rule of reason across the board.

Section III of the brief briefly discusses the alleged boycott which prevented plaintiff from obtaining additional supplies of Monsanto's products. It argues that the efficiency-based characterization approach adopted in *Broadcast Music* should be applied to group boycotts as well as to price fixing agreements. Section IV touches on the problem of concerted action, suggesting that the lack of a clear standard to de-

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[18] *Arizona v. Maricopa County Medical Society*, 102 S. Ct. 2466 (1982).

termine the scope of the *per se* rule has prompted some courts simply to find the absence of concerted action when they believe that the substantive behavior involved should not be an antitrust violation. The final section of the brief argues that a distinction between contract integration and ownership integration is formalistic; if demonstrable economic effect is to determine the scope of the *per se* rule, the legality of contract integrations should be determined by the same standards that are applied to mergers or to integration by internal expansion.

ARGUMENT.

I.

The Economic Determinants of the Scope of the Per Se Rule and the Rule of Reason and the Rule of Reason Inquiry.

The bedrock of market analysis is the voluntary exchange transaction. Two parties will enter such a transaction only if they both believe that they will benefit. The benefits which both parties gain from these transactions are called the gains from trade. Simply put, the purpose of an antitrust policy based on market considerations is to proscribe private arrangements that reduce the gains from trade available to the community as a whole.[19]

Private transactions can either increase or decrease the community's possible gains from trade. Transactions that increase those gains increase efficiency; those that decrease them reduce efficiency. From an antitrust standpoint, arrangements will generally not reduce efficiency unless they restrict output. Arrangements increase efficiency if they reduce the costs of productive marketing activity or produce more desirable products or services.

Some arrangements may have both output restricting and efficiency creating effects. The effect of such a transaction on net available gains from trade can only be determined by estimating the relative magnitude of those two opposing effects. If the gains from more efficient productive activity exceed the losses from a restriction of output, net gains from trade (consumer welfare or economic efficiency) will increase. Net gains from trade will decline if the opposite is true.

A voluntary exchange transaction, thus, can have three possible effects or combinations of effects that are relevant

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[19]The discussion of economic principles is taken from Liebeler, *Intrabrand "Cartels"* at 13. Supporting authorities are cited at that place.

to Sherman Act analysis.[20] The sole probable effect of some transactions will be to restrict output. Those transactions should be illegal *per se*. They can only reduce the total available gains from trade, thereby reducing economic efficiency and consumer welfare.

The sole probable effect of other transactions will be to increase efficiency. These transactions should not be subjects of concern to antitrust. They can only increase the total available gains from trade, thereby increasing economic efficiency and consumer welfare. These transactions should always be legal as far as the antitrust laws are concerned.

Still other transactions will have both of the above effects. They will have the potential both to increase efficiency and to restrict output. The rule of reason should be applied to these transactions and the inquiry under it should focus on the transactions' probable net effect. If the gains from trade available from increased efficiency seem likely to outweigh the losses from the output restriction effect, the transaction should be upheld. It should be struck down if the balance between these two factors appears to shift the other way. This is simply an economic statement of the legal formulation that the rule of reason inquiry is to balance the procompetitive effects of a transaction against its anticompetitive effects.

The crucial point for purposes of this case is that the rule of reason applies to any transaction that has a significant efficiency creating potential. It should also be remembered that a rule of reason inquiry is necessary only if there is a reasonable probability that the transaction will restrict output. The *per se* rule applies only to naked restraints of trade, *i.e.*, those that lack a significant efficiency creating poten-

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[20]This discussion is a verbal statement of the tradeoff model that Professor Williamson first developed to analyze the effects of horizontal mergers. *See* Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 Am. Econ. Rev. 18 (1968); R. Bork. *The Antitrust Paradox* 107 (1978); Liebeler, *Intrabrand "Cartels"* at 16.

tial. It is not the form of the transaction that determines whether or not it is "naked." An arrangement is "naked," and therefore subject to the *per se* rule, only if it lacks an efficiency creating potential. A transaction should be legal without more if it does not have a significant output restricting potential; if both output restricting and efficiency creating effects are present the tradeoff analysis described above should be conducted under the rule of reason.

Since it is difficult to observe the effects of efficiency or market power directly, the law has developed a set of proxies to make the theoretical structure outlined above operational in a legal context. William Howard Taft formulated the classic proxy for efficiency creating potential in 1898 as part of the ancillary restrictions doctrine.[21] Taft's proxy required a contract with a main legitimate end which could be used to determine the scope of the permissible limitation on competition.[22] Professor (now Judge) Bork describes this proxy as "a contract integration (the coordination of other productive or distributive efforts of the parties)."[23] This Court recently described an efficiency creating arrangement for the blanket licensing of copyrights as an "integration of sales, monitoring, and enforcement against unauthorized copyright use."[24] The presence of this integration prompted the Court properly to refuse to apply the *per se* rule, even though the arrangement clearly involved horizontal price fixing.

The paradigm integration of productive facilities is the partnership. Mergers, too, are clearly within the pale. But once again, it is not the form which an integration takes that is important; economic effect is the paramount consid-

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[21] *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd in pertinent part*, 175 U.S. 211 (1899).

[22] 85 F. at 282.

[23] Bork, *Rule of Reason* at 474.

[24] *Broadcast Music, Inc. v. Columbia Broadcasting System*, 441 U.S. 1 (1979) at 20.

eration. All arrangements between a supplier and its resellers, for example, involve an integration of productive facilities; their relationship is the economic equivalent of a partnership, embodying the efficiency-creating potential which Taft specifically recognized in his third example of an ancillary restraint in *Addyston Pipe & Steel.*[25] This "partnership" nature of the relationship between a supplier and its resellers should be enough in itself to remove all arrangements between them from the *per se* rule. The Court accepted this at least partially in *Sylvania* when it recognized the free rider problem and held that nonprice distribution arrangements should be governed by the rule of reason. We shall see below that the inability to make a principled distinction between "nonprice" and "price" restrictions provides an additional reason to extend this efficiency analysis to all arrangements between a supplier and its resellers in a restricted distribution system.

II.

The Distinction Between "Price" and "Nonprice" Distribution Restrictions Is Intractable: The Scope of the *Per Se* Rule and the Rule of Reason as Applied to Such Restrictions Can Only Be Determined by an Efficiency Standard.

Under *Sylvania* the rule of reason is applied to "nonprice" distribution restrictions; the *per se* rule continues to govern "price" restrictions. While it made the distinction between these two types of arrangements crucial, *Sylvania* itself did not address the difference between them. It was presumably thought that the distinction would not be dif-

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[25] "Again, when two men became partners in a business, although their union might reduce competition, this effect was only an incident to the main purpose of a union of their capital, enterprise, and energy to carry on a successful business, and one useful to the community. Restrictions in the articles of partnership upon the business activity of the members with a view of securing their entire effort in the common enterprise, were, of course, only ancillary to the main end of the union, and were to be encouraged." 85 F. at 280.

ficult to make. As subsequent lower court cases attempting to apply *Sylvania* have shown, however, that distinction is intractable.[26]

The difficulty arises because most "nonprice" distribution arrangements are designed to solve free rider problems. These problems typically arise when one dealer cuts prices below the level that covers the cost of providing point-of-sale services desired by the manufacturer. In this regard *Sylvania* said:

> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. These "redeeming virtues" are implicit in every decision sustaining vertical restrictions under the rule of reason. Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. . . . Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's good will and the competitiveness of his product. Because of market imperfections such as the so-called "free rider" effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did.[27]

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[26]Compare the decision below, for example, with ***Bruce Drug, Inc. v. Hollister, Inc.***, 688 F.2d 853 (1st Cir. 1982), and ***Davis-Watkins Co. v. Service Merchandise Co.***, 686 F.2d 1190 (6th Cir. 1982). In both of the latter two cases a termination and boycott after receiving complaints about price cutting were held not to be price related and, therefore, not subject to the *per se* rule. The decisions of the courts of appeals on this issue have been *ad hoc*; there is no principled basis on which the divergent decisions on the price/nonprice issue can be explained.

[27]433 U.S. at 54-55.

The reason that these services might not be provided by retailers, of course, is that price cutting by one or more dealers who fail to provide such services will prevent other dealers from recovering the costs of providing them. If they cannot recover their costs, they will not continue to provide the services, at least not at the optimal level.

It becomes clear, therefore, that free rider problems cannot be solved unless would-be free riders can be prevented from cutting prices. The so-called "nonprice" arrangements to which *Sylvania* applied the rule of reason must be able to prevent or control price cutting before they can be effective. "Nonprice" arrangements, therefore, have powerful effects in terms of stabilizing prices.[28] Tyler Baker makes this point as follows:

> Virtually all of the justifications for *Sylvania* assume an indirect effect on price. For example, the Court referred to "market imperfections such as the so-called 'free rider' effect" that might discourage retailers from providing the appropriate level of services. The same discounters that provide the price competition favored by the enforcement agencies may also "free ride" on the efforts of the authorized dealers. A "free rider" takes advantage of a competitor's investment and charges a price lower than the competitor's, thereby preventing the competitor from recouping its investment. The elimination of free riders may encourage investment, but it also may raise prices. For this reason a rule condemning all vertical restrictions having an

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[28]Both Petitioner and the United States as *Amicus Curiae* recognized the price effects of "nonprice" restrictions. *See* Petitioner's Brief at 26. The Solicitor General noted specifically that "many restrictions commonly regarded as nonprice vertical restrictions, including the location clause at issue in *Sylvania*, may have an upward effect on the resale price of the manufacturer's products." Brief for the United States as *Amicus Curiae* in Support of Petitioner at 16. Neither brief provides a satisfactory solution to the dilemma which they both recognize.

indirect effect on price is flatly inconsistent with *Sylvania*.[29]

The conflict that arises between the price effects of "non-price" restrictions and the breadth of the traditional rule against price fixing can best be seen by quoting some recent language from a decision in the Fourth Circuit Court of Appeals discussing *Socony-Vacuum*:[30]

> [P]rice fixing is one of those practices that the Court has held to be illegal per se. . . . The Court stated [in *Socony*] "a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se." To be guilty of price fixing, the conspirators do not have to adopt a rigid price, substantially less has been found to be price fixing. An activity can violate the per se rule even if its effect upon prices is indirect. . . . In essence, an interference with market forces freely setting the prices of goods is sufficient.[31]

The traditional expression of the *per se* rule devours "non-price" restrictions once we recognize, as we must, that the purpose and effect of "nonprice" arrangements is to affect prices. *Sylvania* and *Socony* are at war with each other; either *Socony* must be tempered in some way or *Sylvania* must give way. While a futile formalistic accommodation between *Socony's* flat prohibition of arrangements that affect prices and *Sylvania's* mandate to apply the rule of reason to "nonprice" restrictions could be made, *Sylvania* requires that this problem be solved in terms of demonstrable economic effect.

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[29]Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is* Sylvania *A Way Out?* 67 Va. L. Rev. 1457 (1981) at 1467.

[30]*United States v. Socony-Vacuum Oil Co. Inc.*, 310 U.S. 150 (1940).

[31]*National Electrical Contractors Association, Inc. v. National Constructors Association*, 678 F.2d 492 (4th Cir. 1982) at 500.

That can be done by following the approach that the Court took in defining price fixing in *Broadcast Music*. There the Court refused to apply the *per se* rule to blanket copyright licenses issued by BMI, even though those licenses eliminated competition between individual copyrighted works and necessarily fixed prices. The Court said:

> To the Court of Appeals and CBS, the blanket license involves "price fixing" in the literal sense: the composers and publishing houses have joined together into an organization that sets its price for the blanket license it sells. But this is not a question simply of determining whether two or more potential competitors have literally "fixed" a "price." As generally used in the antitrust field, "price fixing" is a shorthand way of describing certain categories of business behavior to which the *per se* rule has been held applicable. The Court of Appeals' literal approach does not alone establish that this particular practice is one of those types or that it is "plainly anticompetitive" and very likely without "redeeming virtue." Literalness is overly simplistic and often overbroad. When two partners set the price of their goods or services tney are literally "price fixing," but they are not *per se* in violation of the Sherman Act. . . . Thus it is necessary to characterize the challenged conduct as falling within or without that category of behavior to which we apply the label "*per se* price fixing." That will often, but not always be a simple matter.[32]

In establishing a standard by which to "characterize the challenged conduct as falling within or without the category of behavior to which we apply the label '*per se* price fixing' " the Court wrote:

> More generally, in characte.izing this conduct under the *per se* rule, our inquiry must focus on whether the effect, and here because it tends to show effect . . . the purpose of the practice is to threaten the proper

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[32]441 U.S. at 8-9.

> operation of our predominantly free market economy — that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, and in what portion of the market, or instead one designed to "increase economic efficiency and render markets more rather than less competitive." . . . The blanket license, as we see it, is not a "naked restraint of trade with no purpose except stifling of competition," . . . but rather accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use.[33]

This language nicely brings together many of the points made in Section I of this brief. Justice White's language looks to output and competition restriction and efficiency creation as the principal determinants of the scope of the *per se* rule. A "naked" restraint is recognized as one which does not accompany an integration of productive facilities, which is used as a proxy for efficiency creating potential. Under the *Broadcast Music* approach, any arrangement that is not a "naked restraint of trade," *i.e.*, that has a significant efficiency creating potential, would fall outside the category of "*per se* price fixing."[34] Since there was an integration of productive facilities involved in Monsanto's distribution system, and since that integration had the potential to create significant efficiencies of the type contemplated in *Sylvania*, the *Broadcast Music* approach would apply the rule of reason in the present case.

There remains, however, the question of when the efficiency-based characterization process adopted in *Broadcast Music* comes into play and when the "literal" approach to characterizing *per se* price fixing is appropriate. *Broadcast Music* itself did not answer this question. The most obvious answer, of course, is that the efficiency-based process should

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[33] *Id.* at 19-20.

[34] The restriction on competition must, of course, also be ancillary to the efficiency creating integration, as it appears to be in this case.

apply to all price fixing cases and, indeed, to all other transactions challenged under Section 1 of the Sherman Act as well.

This would not be difficult. The basic question in each case after an output restricting potential appeared would be whether the arrangement was a naked restraint of trade, *i.e.*, without any significant efficiency creating potential. In most cases this question could be answered by inspecting the limitation on competition to see if it accompanied and was ancillary to an integration of productive facilities.[35] Appearance of this proxy for efficiency creating potential would signal the courts to move to the rule of reason inquiry or, at the very least, to a preliminary inquiry on the ancillarity issue.

If it were not for *Maricopa*, there would not be any reason to suppose that the *Broadcast Music* approach should not apply to all alleged price fixing agreements. In *Maricopa*, however, insisting that the Court had never wavered from the position that price fixing was illegal *per se*, Justice Stevens applied a literal *per se* approach to a system for delivering health care services that clearly produced significant cost savings. Justice Stevens relied heavily on *Socony* for the proposition that *all* price fixing arrangements are *per se* violations of Section 1 of the Sherman Act even though they may have, as was assumed on certiorari in *Maricopa*, "saved patients and insurers millions of dollars."[36] This position made it impossible for the majority to articulate a principled explanation of the Court's unanimous conclusion

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[35] An integration of productive facilities will serve as an adequate proxy for efficiency creating potential most of the time. There may be some cases, however, where the efficiency creating potential is more subtle; it may be present even in the absence of an integration of productive facilities as that term is commonly understood. *See* Liebeler, *Book Review*, 66 Cal. L. Rev. 1317 (1979) at 1328-33. Most of the time, however, and certainly in this case, the integration of productive facilities will be a satisfactory proxy for efficiency creating potential.

[36] 102 S. Ct. at 2472.

in *Broadcast Music* that the *per se* rule did not apply to the price fixing involved in the blanket copyright licenses granted by BMI and ASCAP. The majority could only indicate that the arrangement in *Maricopa* was "fundamentally different" from those in *Broadcast Music*, a position that the dissent found unsatisfactory.

The nature of the problem was clearly stated in Justice Powell's dissent:

> It is settled law that once an arrangement has been labeled as "price fixing" it is to be condemned *per se*. But it is equally well settled that this characterization is not to be applied as a talisman to every arrangement that involves a literal fixing of prices. Many lawful contracts, mergers, and partnerships fix prices. But our cases require a more discerning approach. The inquiry in an antitrust case is not simply one of "determining whether two or more potential competitors have literally 'fixed' a 'price.' . . . [Rather], it is necessary to characterize the challenged conduct as falling within or without that category of behavior to which we apply the label "*per se* price fixing." That will often but not always, be a simple matter. *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., supra*, at 9.
>
> Before characterizing an arrangement as a *per se* price fixing agreement meriting condemnation, a court should determine whether it is a "naked restrain[t] of trade with no purpose except stifling of competition." *United States v. Topco Associates, Inc.*, 405 U.S. 596, 608 (1972), quoting *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963). See also *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49-50 (1977). Such a determination is necessary because "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *Id.*, at 58-59. As part of this inquiry, ***a court must determine whether the procompetitive economies that the arrangement purport-***

edly makes possible are substantial and not realizable in the absence of such an agreement.[37]

The dissent concluded:

> As in *Broadcast Music*, the plaintiff here has not yet discharged its burden of proving that respondents have entered a plainly anticompetitive combination without a substantial and procompetitive efficiency justification. In my view, the district court therefore correctly refused to grant the State's motion for summary judgment. This critical and disputed issue of fact remains unresolved.[38]

In the present case it is quite clear that plaintiff could not show that Monsanto's restricted distribution system did not have a substantial and procompetitive efficiency creating capacity. Absent such a showing, the *Broadcast Music* characterization approach would lead to the conclusion that Monsanto's conduct could not have constituted "*per se* price fixing."

Broadcast Music and *Maricopa* have not indicated when the *per se* rule should be applied literally and when the efficiency-based characterization process adopted in *Broadcast Music* must be undertaken. *Broadcast Music* provided little guidance on this issue; *Maricopa* compounded the confusion by applying a literal *per se* rule to an arrangement that quite clearly should have received the kind of analysis used in *Broadcast Music*. Our question, of course, is what are the implications of all this for using the efficiency-based characterization process to determine the scope of the *per se* rule in the context of distribution restrictions.

From a legal standpoint, the dilemma posed by the "price"/"nonprice" distinction advanced in *Sylvania* is a much more difficult problem than was involved either in *Broadcast Music* or in *Maricopa*. The arrangements in those

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[37] *Id.* at 2482 (emphasis added).

[38] *Id.* at 2485.

cases either explicitly fixed prices (*Maricopa*) or were such that price fixing was a necessary effect of the arrangement (*Broadcast Music*). In either of those cases, therefore, the Court could have applied the literal *per se* rule without being out of line with the main body of traditional price fixing doctrine. No matter what one might think of such results from an economic perspective, the legal tools were at hand to decide those cases in a way that would not have been absurd when judged only by the standards of traditional legal doctrine.

This is not the case when it comes to dealing with the distinction between "price" and "nonprice" restrictions. As indicated above, it is simply impossible to make this distinction in a principled way by using a formalistic (legal) or literal approach. "Nonprice" restrictions clearly have the purpose and effect of reducing or eliminating price cutting by putative free riders; they thereby operate at least to stabilize prices. Under traditional doctrine any agreement with such a purpose and effect, whether vertical or horizontal, is a *per se* illegal price fixing agreement. If *Socony* is applied without qualification, as it was in *Maricopa*, the category of "nonprice" restrictions becomes an empty set.

This is not acceptable. *Sylvania* holds that there are such things as "nonprice" distribution arrangements. But the distinction between "price" and "nonprice" arrangements is impossible to make on the basis of traditional legal doctrine. The only way out of this dilemma — to find some principled way to qualify and limit *Socony* — is to maintain the efficiency-based characterization approach adopted in *Broadcast Music*. We need not discuss the general scope of *Broadcast Music* or discuss the correctness of *Maricopa* to reach this conclusion and decide this case. Necessity alone dictates applying *Broadcast Music* to the dilemma created by the distinction between "price" and "nonprice" distribution agreements.

Once this is done, the efficiency creating capacity of Monsanto's restricted distribution system makes the *per se* rule inapplicable. It becomes clear that the decision below must be reversed.

III.

The *Broadcast Music* Approach Should Also Be Applied to the Alleged Boycott: Since It Also Had Significant Capacity to Create Efficiency It Must Also Be Governed by the Rule of Reason.

The court below upheld a jury instruction that group boycotts were illegal *per se* and that it should find that Monsanto violated Section 1 of the Sherman Act if it found that Monsanto agreed with some of its distributors to terminate plaintiff's distributorship or limit plaintiff's access to Monsanto products. Monsanto argued that only horizontal boycotts were *per se* illegal and that vertically imposed boycotts were subject to the rule of reason. The court held, on the basis of *Klor's* and *General Motors*, that an agreement between Monsanto and some of its distributors to terminate plaintiff was *per se* illegal even if it was not part of a scheme to fix retail prices.[39]

The decision below is faulty even granting the continuing vitality of *Klor's* and *General Motors*. The court simply misstated the facts of *Klor's*;[40] *General Motors* was based on a horizontal agreement between the resellers, a factor not involved in the present case. For these reasons alone, the court below must be reversed on its boycott holding.

But this holding must also be reversed for all the reasons set forth in Section II above. The efficiency-based char-

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[39]684 F.2d at 1235-36.

[40]The court below said that "[i]n *Klor's*, a manufacturer and several retail stores agreed to boycott a retail store that competed with some of the boycotters." *Id.* at 1236. *Klor's* actually involved an agreement between one retail store (Broadway-Hale) and several manufacturers under which the manufacturers agreed not to supply Klor's with certain items sold by The Broadway.

acterization process adopted in *Broadcast Music* is just as relevant to determining the scope of the *per se* rule as applied to group boycotts as it is to price fixing agreements. This approach has in fact been applied to group boycotts in an extremely able opinion by Judge Goldberg in the Fifth Circuit.[41] In dealing with a claim that certain restrictions on admission to a multiple listing service were *per se* illegal, he wrote:

> In light of the potency of the *per se* rule, however, the Supreme Court has recently reemphasized that the invocation of this conversation stopper must be limited to those situations which fairly fall within its rationale.[42]

After citing and discussing *Broadcast Music* and *Sylvania*, Judge Goldberg concluded:

> These and other recent cases make it clear that the legal characterization of a class of restraints requires "a judgment about [its] competitive significance" and that, in formulating that judgment, courts must pay heed to relevant "economic conceptions". . . .[43]

Since a multiple listing service carries with it a significant efficiency creating potential, the Fifth Circuit refused to apply the *per se* rule to the membership restrictions which that listing service had adopted. The efficiency creating capacity of restricted distribution systems strongly suggests that the same result should be reached here.

This conclusion is also supported by the fact that *Sylvania* sharply undercut the precedential value of *Klor's* and *General Motors*, the principal cases on which the court below relied in applying the *per se* rule to the alleged boycott in this case. The restrictions on competition in both of those cases seem to have been adopted to alleviate free rider problems similar to those involved in *Sylvania*. Indeed, it

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[41] *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351 (5th Cir. 1980). *See* W. [illegible]r, *Antitrust Advisor* §1.32 (2d ed. Supp. 1982).

[42] 629 F.2d [illegible]

[43] *Ibid.*

would not be going too far to conclude that *Sylvania* clearly even if implicitly overruled both of those cases, each of which has been sharply criticized.[44] It is respectfully suggested that the Court take this opportunity to clarify the relationship between *Sylvania* and these earlier cases, affirming and extending the *Sylvania* approach.

For all of these reasons, the court below should be reversed on its group boycott holding.

IV.
The Problem of Concerted Action.

This brief does not discuss in detail the question whether complaints to a supplier by one reseller about another reseller's price cutting followed by the latter's termination is sufficient evidence to go to the jury on the issue of concerted action. It does, however, suggest that so much emphasis has been placed on this issue because the courts have not been able to develop coherent standards for applying the *per se* rule and the rule of reason or for applying the rule of reason itself once concerted action is found. It appears that a refusal to find concerted action many times represents a judgment that the substantive behavior involved should not be treated as an antitrust violation.[45]

The rigidities of the *per se* rule require safety valves for its avoidance in those cases where its application seems inappropriate. One of those safety valves, as we have seen,

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[44]*See Products Liability Insurance Agency, Inc. v. Crum & Forster Insurance Co.*, 682 F.2d 660 (7th Cir. 1982); Liebeler, *Book Review*, 66 Cal. L. Rev. 1317 (1979) at 1325; Liebeler, *Intrabrand "Cartels"* at 30; Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. Chi. L. Rev. 1 (1977) at 19-20.

[45]There is a tendency to fall back on *United States v. Colgate & Co.*, 250 U.S. 300 (1919), whenever the going gets tough in this area of the law. This tendency for *Colgate* "to distort the analysis in other, apparently unrelated, areas of antitrust law" has been remarked in Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is* Sylvania *A Way Out*?, 67 Va. L. Rev 1457 (1981) at 1471.

is the process of characterization: If all price fixing agreements are *per se* illegal, the courts will refuse to characterize useful price fixing arrangements as price fixing arrangements. Another safety valve appears in connection with the question of concerted action. If joint action that seems useful would constitute a *per se* violation, many courts will refuse to find joint action. The difficulties of predicting the outcomes of cases under such circumstances are plain; a legal regime like this is inefficient.

These safety valves from the pressures of the *per se* rule would not be necessary if we had a principled way to determine when the *per se* rule applied and when a transaction was governed by the rule of reason. The efficiency-based characterization process of *Broadcast Music* provides a principled way to deal with this problem. Its adoption would help to solve the largely formalistic problems raised by the concerted action issue.

V.

A Distinction Between Contract Integration and Ownership Integration Is Formalistic Line Drawing: If Monsanto Could Legally Own and Operate Its Own Resale Outlets, It Should Legally Be Able to Make Contracts With Its Resellers That Would Replicate the Economic Incidents of Ownership.

Sylvania held that the scope of the *per se* rule and the rule of reason should be determined by demonstrable economic effect, not by formalistic line drawing. That decision necessarily calls into question the double standard that has long applied more rigorous tests of legality to contract arrangements than to ownership arrangements. Why, for example, should the *per se* rule ever be applied to a contract between a supplier and its resellers determining the manner in which the resellers should handle the supplier's product, when it would never be applied to a merger between those parties or to the supplier's expansion into reselling by means of internal growth? There is no satisfactory answer to this

question in terms of demonstrable economic effect. The distinction is based on the formal differences between contract integration and ownership integration or on concern for the "freedom of traders," a concern that is not based on market considerations and which was explicitly rejected in *Sylvania*. After *Sylvania*, the same standards should be applied to contractual arrangements between a supplier and its resellers as would be applied to the acquisition of those resellers by the supplier, or to the supplier's integration into the resale level by means of expansion by growth. Under that standard the *per se* rule could not be applied in the present case, or indeed, in any other case involving restricted distribution arrangements.

This point was recently made by Judge Gee in an opinion of the Fifth Circuit Court of Appeals.[46] In upholding certain restrictions which Liquid Carbonic Corp. had placed by contract on its resellers, Judge Gee wrote:

> The final reason why we find the presumed reduction in intrabrand competition insufficient to constitute injury to competition is that, given the apparent nature of the market and Liquid's relative place in it, Liquid most probably could have chosen, consistent with the antitrust laws, to do all of its own distributing in the New Orleans area, either by cancelling its distributors and expanding internally or by simply acquiring the distributors themselves. If Liquid had thus vertically integrated into distribution, it clearly could have instructed its employees to abide by territorial and customer restrictions. And since Liquid could have accomplished these ends by either internal expansion or merger, either of which would have had an even greater impact on intrabrand competition, we fail to see why it would have been unreasonable for Liquid to accomplish the same ends by contract.[47]

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[46]*Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001 (5th Cir. 1981).

[47]*Id.* at 1006.

This conclusion is consistent with the economic analysis of the scope of the *per se* rule and the rule of reason set forth above. It provides still another reason why the judgment below should be reversed.

Conclusion.

The Court should reverse the judgment of the court below. That can be done most consistently both with the prior decisions of this Court and with the principles of demonstrable economic effect by applying the efficiency-based characterization process adopted in *Broadcast Music* to the problem of determining the scope of the *per se* rule and the rule of reason in restricted distribution cases. The same approach should be applied to the boycott issue, as discussed above.

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Respectfully submitted,

Wesley J. Liebeler,
(Counsel of Record),
UCLA Law School,
Attorney for Amicus Curiae.

APPENDIX A.

UCLA Faculty Members Who Are Members of Associates for Antitrust Analysis Together With Their Departmental Affiliation.*

ARMEN A. ALCHIAN
Department of Economics

JEFFREY CONNER
Graduate School of Management

HAROLD DEMSETZ
Department of Economics

MICHAEL GRANFIELD
Graduate School of Management

ROBERT L. JORDAN
School of Law

WESLEY J. LIEBELER
School of Law

STANLEY ORNSTEIN
Graduate School of Management

*The foregoing brief was drafted by counsel. It has been reviewed by each of the persons listed above. Each of them agrees generally with the statements made in the brief even though some of them might have expressed particular points in somewhat different form than they were actually expressed by counsel.